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# **Improving Employment Prospects in the Slovak Republic**

**BUILDING ON PAST REFORMS**

Andrés Fuentes<sup>\*</sup>

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BUILDING ON PAST REFORMS**

**ECONOMICS DEPARTMENT WORKING PAPERS No. 579**

by  
**Andrés Fuentes**

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## **Abstract/Résumé**

### **Improving employment prospects in the Slovak Republic: building on past reforms**

While employment growth has accelerated, allowing unemployment to fall significantly since 2005, many low-skilled workers are still unemployed and the duration of unemployment spells is still long. The introduction of an in-work benefit for workers in low-income households, subject to a minimum of hours worked, could lower barriers to higher employment which result from a relatively high tax wedge on low-skill workers, as would the elimination of poverty traps in the pension system. Measures to improve mobility of workers across regions, notably housing policy reform, would lower long unemployment durations, as would the provision of more training to the unemployed. Impediments to higher labour market participation of young women and older workers need to be removed.

*JEL classification:* J21, J26, J32, J38, J59

*Key words:* Employment, unemployment, labour market participation, employment protection legislation, minimum wages, active labour market policies, in-work benefits

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### **Améliorer les perspectives d'emploi en la République slovaque : faire fond sur les réformes passées**

Si la croissance de l'emploi s'est accélérée, permettant un recul notable du chômage depuis 2005, néanmoins il y a encore beaucoup de travailleurs peu qualifiés au chômage et la durée des épisodes de chômage reste longue. L'introduction d'une prestation liée à l'exercice d'une activité pour les travailleurs appartenant à des ménages à faible revenu, sous réserve d'un volume minimum d'heures travaillées, pourrait abaisser les obstacles à l'augmentation de l'emploi qui résultent du fait que le coin fiscal qui pèse sur les revenus des travailleurs peu qualifiés est relativement élevé, et l'élimination des trappes à pauvreté que crée le système de pension devrait avoir le même effet. Des mesures visant à accroître la mobilité des travailleurs entre régions, notamment avec une réforme de la politique du logement, permettraient de réduire les durées de chômage, de même qu'une offre accrue de formation à l'intention des chômeurs. Les éléments qui font obstacle à une plus forte participation des femmes jeunes et des travailleurs seniors à l'activité devraient être supprimés.

*Classification :* J21, J26, J32, J38, J59

*Mots clés :* Emploi, chômage, participation au marché du travail, protection de l'emploi, salaire minimum, programmes du marché du travail, pensions, prestations liées à l'exercice de l'emploi

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## **IMPROVING EMPLOYMENT PROSPECTS IN THE SLOVAK REPUBLIC: BUILDING ON PAST REFORMS**

By

Andrés Fuentes<sup>1</sup>

1. The Slovak Republic has introduced reforms of substantial depth and breadth in recent years to improve labour market performance. Employment protection legislation (EPL) was liberalised in 2003 for workers on both permanent and temporary contracts. Welfare reform, effective since 2004, reduced means-tested social assistance benefits, lowering benefit replacement rates for the unemployed after expiry of unemployment insurance benefits, which are paid over a period of 6 months. Pension reform raised the statutory retirement age to 62 years for men and to this age for women by 2014 and increased the pension discounts applicable in early retirement. The reforms have had a noticeable impact on labour market performance. Employment rates of older workers have risen markedly. Unemployment has fallen significantly since 2005, as the labour market has benefited from strong economic growth.

2. Nonetheless, the Slovak Republic continues to face considerable challenges in the labour market. Unemployment is still high and the recent decline in unemployment has been accompanied by a strong increase in vacancies – by 67% between the second quarter of 2004 and the second quarter of 2006 –, suggesting that the decline has to some extent been cyclical. To lower structural unemployment, the following policy challenges need to be addressed:

- Unemployment is particularly high among workers with inadequate skills, which includes graduates from upper secondary vocational schools not leading to tertiary education. Reforms in the education system therefore play a crucial role in improving employment prospects in the longer term (Carey, 2007). However, education policies take time until they substantially affect the composition of labour supply. While replacement rates of benefits available to the unemployed are already low, measures are still needed to remove employment barriers resulting from a relatively high tax wedge for low-skill workers. Moreover it is necessary to ensure that the statutory minimum wage remains at a level that does not reduce labour demand for low-skill workers.

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1. This paper is based largely on material from the *OECD Economic Survey of the Slovak Republic* published in April 2007 under the authority of the Economic and Development Review Committee (EDRC). The author would like to thank Catherine Saget, Val Koromzay, Andrew Dean, Andreas Wörgötter and David Carey for valuable comments on earlier drafts. The paper has also benefited from discussion with the Slovak authorities. Special thanks go to Béatrice Guerard for technical assistance and to Sylvie Ricordeau and Susan Gascard for technical preparation.

- The long-term unemployment rate is the highest among OECD countries and has fallen little. Long-term unemployment is particularly widespread among young workers. To some extent the favourable impact of strong economic growth as well as past welfare and EPL reforms on long-term unemployment is subject to lags and has to a large extent not been visible yet (OECD, 2007a, Chapter 1). Nonetheless, as shown below, policy settings still need to be made more conducive to reducing the duration of unemployment spells.
- Disparities in regional labour market performance remain large. Unemployment rates are higher in Eastern regions than in Western regions, contributing to overall low labour utilisation and to regional income inequality. Low mobility of workers across regions contributes to these disparities and slows the transition of the unemployed into jobs, contributing to the long duration of unemployment spells. Policies to address low regional labour mobility and to ensure flexibility of wages across regions are thus necessary.
- To safeguard the continued expansion of employment, it is important that the labour market can absorb economic shocks without generating persistent unemployment. The government is currently preparing employment protection legislation (EPL) amendments. If changes to EPL significantly increase the cost dismissing workers, the ability of the labour market to adjust to such shocks may be harmed.

3. Barriers to higher labour market participation are also limiting employment growth: Notwithstanding recent improvements, participation rates of workers above the age of 55 are still relatively low, including among men, for whom the legislated increase in the statutory retirement is already fully phased in. Participation of young women has been falling. Hurdles to higher labour market participation of these groups need to be removed. Removing such hurdles would also help softening the adverse impact of population ageing on living standards over the next four decades, which is among the most severe in the OECD.

The remainder of the working paper discusses these challenges and proposes policies to address them.

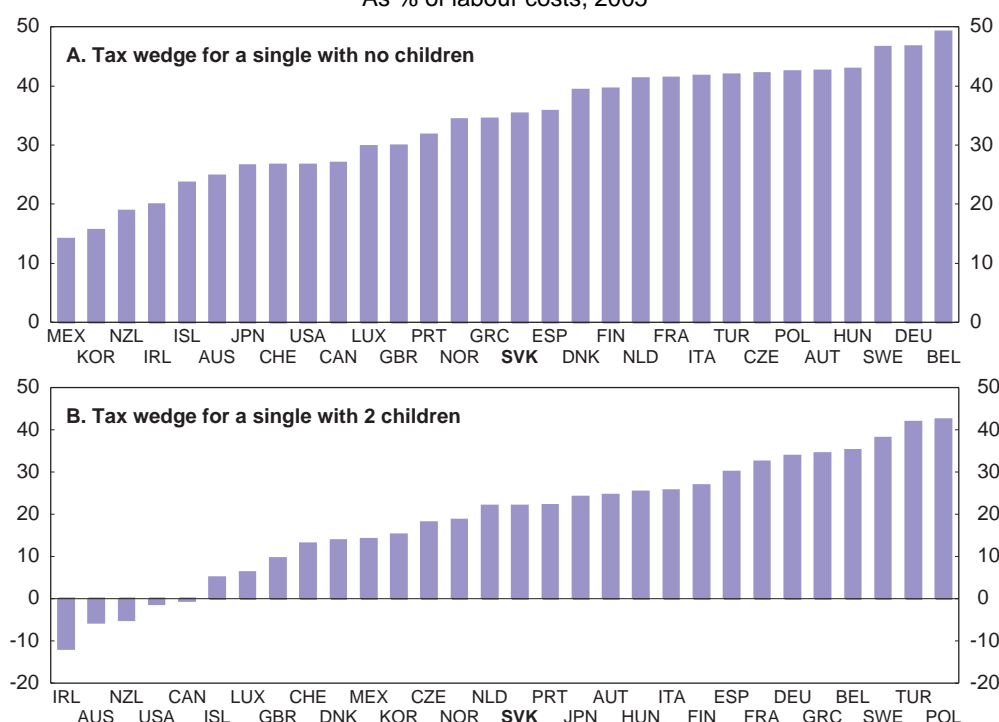
### **Employment barriers for low-skill workers are still significant**

4. In recent years, the tax wedge on labour has fallen. Income tax reform, effective since 2004, contributed to this development, mostly by lowering marginal tax rates at higher income levels. Social security payroll contributions also fell, mostly as a result of the introduction of the second-pillar funded pension scheme. Total pension contributions amount to 18% of gross wage income. One half of the pension contributions paid on behalf of workers who entered the labour market from 2005 onwards are directed to the new compulsory funded second-pillar pension scheme. In addition, other workers had the option of signing up to the second pillar until June 2006. Workers not enrolled in the new second-pillar scheme continue to pay the full 18% contribution into the earnings-related pay-as-you go (PAYG) pension regime. Excluding the contributions to the new second-pillar scheme, which are not included in the OECD measure of the tax wedge, the measured tax wedge on low-skilled workers is slightly higher than the average of OECD countries (Figure 1). At the same time, unemployment is high among poorly qualified workers (see Carey (2007)).

***Poverty traps in the pension system generate disincentives to work for low-skill workers***

5. There is a risk that contributions to both the reformed first pillar<sup>2</sup> and the second pillar pension regimes are to a large extent perceived as taxes, in particular by workers with modest earnings capacity, creating disincentives to work in the legal economy. A substantial proportion of workers appears likely to reach a pension in retirement that does not exceed social assistance benefits significantly (see Box 1). Pension payments in both the reformed first pillar and the second pillar are strictly proportional to contributions made in most cases, resulting in relatively low pension benefits for workers with relatively low earnings. The tax treatment of first and second-pillar pensions reinforces the proportional relationship between benefits and earnings, as contributions are not included in taxable income and accruals and pension benefits are tax-exempt (i.e., exempt-exempt-exempt (EEE) arrangements). For pensioners with a contribution record of 25 years, social assistance is withdrawn at a rate of 75% as the pension increases, with the withdrawal rate diminishing by one percentage point for each additional year of contribution record. The proportion of workers who will be entitled to social assistance under the reformed pension system could be reduced by extending redistribution in the system. To this end mandatory pensions could be subject to personal income tax (either EET or TEE) and resulting revenues be used to raise first pillar pensions, leaving the average net pension unchanged. Moreover, to reduce poverty traps in the pension system further, the rate at which social assistance payments to pensioners are withdrawn as pension income rises should be lowered.

Figure 1. **Average tax wedge at 67% of average wage earnings (AW)**  
As % of labour costs, 2005



Source: OECD (2006), Taxing Wages, Table II.1.

2. The first pillar PAYG pension system was reformed in 2003 and will be fully applied to pension payments from 2015 onwards. See OECD (2005e) for a detailed description of the reformed pension regime and the 2004 *Economic Survey of the Slovak Republic* for a description of the new funded second pillar pension regime.



6. The risk that a substantial proportion of future pensioners may receive social assistance reinforces the need to raise the statutory retirement age to ensure that pensioners accumulate sufficient financial wealth in the second-pillar pension system to receive an annuity which lifts their overall pension entitlement above social assistance.

**Box 1. A significant proportion of pensioners who will retire under the reformed pension system will be entitled to social assistance**

A single worker who pays all payroll contributions into the reformed first-pillar pension scheme will need to earn more than 70% of average earnings during an uninterrupted contributions record from age 20 to the statutory retirement age of 62 in order to accumulate a pension entitlement that, on average over the whole retirement period, exceeds the social assistance entitlement, assuming that social assistance entitlements are adjusted over time in line with average wage growth. According to earnings distribution data from 2004, about 37% of all full-time workers have wage earnings less than 70% of the average earnings. Since the social assistance entitlement is more generous for a couple than for a single person, workers with a non-working spouse would need to earn more than 110% of average earnings to receive a pension which is worth more than the social assistance entitlement<sup>1</sup> Since the employment rate is low, especially for low-skill workers, interrupted work records are frequent, increasing the risk that workers will receive social assistance when retiring. Moreover, while female labour market participation is still high, participation of young women has been falling, as noted above.<sup>2</sup>

The risk that pension entitlements may not exceed social assistance entitlements is also significant for workers who contribute to the second pillar pension system. The productivity convergence process raises real wage growth and depresses the real return on assets, relative to higher income countries. If the real return on assets in the second pillar is below the growth of real wages, the pension entitlement accumulated in the second pillar could be less than the pension entitlement accumulated in the first pillar.<sup>3</sup> Real trend productivity growth, which determines real wage growth in the long run, is currently estimated at 4%. With the nominal interest rate on long-term euro area government bonds between 4 and 4.5 %, the low-risk real return could be as low as 1%, assuming a inflation rate of 2% for the euro area and a trend inflation differential for the Slovak Republic vis-à-vis the euro area of 1 to 1.5%, in line with the trend real appreciation in the long run estimated by the Slovak National Bank. On the other hand investments in equities have a significantly higher expected return than government bonds, lowering the risk that pensioners will be entitled to social assistance.

1. The pension entitlement of a worker with full contribution record from age 20 to 62 is equal to 48.6% of the average wage upon retirement (see OECD, 2005e). Pension growth during retirement is half indexed to prices and half to wages. Since pensions grow less than real wages, the risk of pensioners receiving social assistance rises during retirement if social assistance increases in line with real wages as assumed here. It is assumed that economy-wide real wage growth over the residual life expectancy amounts to 3%, as projected in the baseline projection of the European Commission (2006). The social assistance allowances for a single retiree amounts to 30% and for a couple 47% of the average wage (including supplements such as for housing). See OECD (2006).

2. Workers in two-earner couples need to earn more than 50% of average earnings over a complete contributions record in order to obtain a pension entitlement that exceeds social assistance.

3. Pension contributions in the first pillar are revalued in line with wage growth in the course of the contribution history.

7. Performance of the second-pillar pension scheme could be depressed by the requirement that at least 30 % of financial investments in the scheme be used to purchase domestic financial assets. At present, this requirement does not appear to be binding, as investment funds invest considerably more than 30% of portfolios in domestic assets. However, the value of asset portfolios in the second pension pillar is still relatively small and will grow very substantially over the next three decades. In view of the small size of the capital market in the Slovak Republic, especially with regard to higher-return equity, fulfilling this requirement may become increasingly difficult as the portfolios grow in size, with adverse affects on the risk-return characteristics of second-pillar pension portfolios as they grow in size. In this case, a

deterioration of portfolio performance could contribute to raising the risk that pensioners will depend on social assistance. The requirement that 30% of financial investments in the second-pillar pension scheme be directed to domestic assets should be phased out.

8. Voluntary funded pension schemes (the third-pillar pension schemes) benefit from the same tax advantages as the first and second-pillar schemes, with contributions tax deductible and accrued interest and pension annuities not subject to taxation, creating a significant loophole in the tax system. While third-pillar pensions can, in principle, provide revenues to top up pensions from the first and second pillar-pension system, there are no statutory limits to the early withdrawal of savings accumulated in the third-pillar pension system, creating incentives to withdraw the savings early in order to be able to receive social assistance as retirement income. Third-pillar pensions should be subject to personal income tax. The resulting revenues could be used to reduce the rate at which social assistance benefits are withdrawn as pension entitlements rise. The degree to which lump sum withdrawals from third-pillar pension schemes are allowed should be limited so long as these schemes benefit from preferential tax treatment.

***In-work benefits can improve employment prospects of low-skill workers and reduce child poverty***

9. One instrument a number of OECD countries have used to improve employment prospects among low-skill workers while at the same time reducing poverty are in-work benefits. In-work benefits supplement the disposable income of households in which at least one adult works but in which household income is nonetheless insufficient to keep the family out of poverty, improving incentives to take up work among workers with low earnings potential, notably in households in which no adult works. The level of such in-work benefits can depend on the number of children in the household, helping to alleviate child poverty. Indeed, poverty in the Slovak Republic is concentrated on households with children (see Chapter 1). Moreover, as in other countries, disincentives to work for social assistance recipients are more pronounced in households with children than in other households. On the other hand, as the in-work benefits would be withdrawn as household income rises, the in-work benefit generate disincentives to work at higher income levels, which may in particular lower labour supply in two earner households.<sup>3</sup> Therefore, in-work benefits should not be seen as the only tool to improve employment prospects of low-skill workers. Improvements in the education system are essential to reduce the incidence of low-skill unemployment (see Carey (2007)). However, such improvements take time to reach a substantial share of the labour force.

10. The Slovak Republic has introduced some benefits to facilitate the transition from non-employment into work. In particular, working parents receive a *tax bonus*, a cash benefit paid to (at most) one employed parent, provided the parent earns more than 50% of the earnings of a full-time worker earning the minimum wage. The benefit currently amounts to SKK 540 per month (3.5% of average monthly wage earnings) per dependent child and is not subject to an income test. In addition, long-term unemployed social assistance recipients receive an *activation allowance* worth SKK 1900 (10% of average monthly wage earnings) for a period of 6 months once they take up employment.<sup>4</sup>

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3. The share of households in which no adult works in the Slovak Republic is significant, albeit not among the highest of European countries for which Eurostat data are available. The number of children living in workless households is also relatively large. These data suggest that an in-work benefit tied to a household-income test would still generate significant improvements in work incentives among households in which no adult works. If the objective is to preserve work incentives among two-earner households, the in-work benefit could be tied to a test of individual earnings rather than a test of household income. In this case the in-work benefit would be less well-targeted on poverty.

4. As social assistance, the allowance is withdrawn at a rate of 75% as labour earnings rise.

11. The tax bonus raises incentives to take up work and contributes to alleviating child poverty to some extent. However the scheme is not well targeted at low wage workers, who face the most severe disincentives to work. Moreover, the *tax bonus* is subject to an earnings floor, rather than a floor on hours worked, which also makes it less well targeted to the low-skilled. The activation allowance does not durably improve work prospects and income of workers with low skills.<sup>5</sup> The introduction of an in-work benefit should be considered, with the level of the benefit depending on the number of children in the household. Any such benefit should be subject to a minimum requirement on hours worked and be phased out gradually above a household income level determined by a poverty threshold. The in-work benefit could replace the tax bonus and the temporary wage subsidy for social assistance recipients, contributing to the funding of such a benefit. In addition, it could be funded from reductions of subsidies to agriculture and the abolition of the annual bonus payments for current pensioners that were introduced in 2006. The incidence of poverty is very low among current pensioners, suggesting that these bonus payments are poorly targeted.

***Minimum wages need to be set such as to preserve employment prospects of poorly skilled workers***

12. An in-work benefit can only raise employment prospects if the minimum wage is sufficiently low such that it does not reduce employment. If this condition is not met, employment is constrained by the labour demand side, so measures to increase labour supply at a given level of labour costs – such as an in-work benefit – would not raise employment. Minimum compensation – taking into account employer-paid social security contributions – does not appear high relative to median compensation and the proportion of workers earning the minimum wage is low, suggesting that the minimum wage does not result in significant employment losses overall (Figure 2). While the government raised the minimum wage by 10.1% in October 2006, which is 2.4 percentage points more than average wage growth,<sup>6</sup> this increase is not sufficiently large to change the situation substantially.<sup>7</sup> However, no evaluation of the employment effects of the minimum wage exists. While the government manifesto<sup>8</sup> calls for incremental increases of the minimum wage, the government recognizes that a high minimum wage entails risks for employment prospects for low-skill workers.

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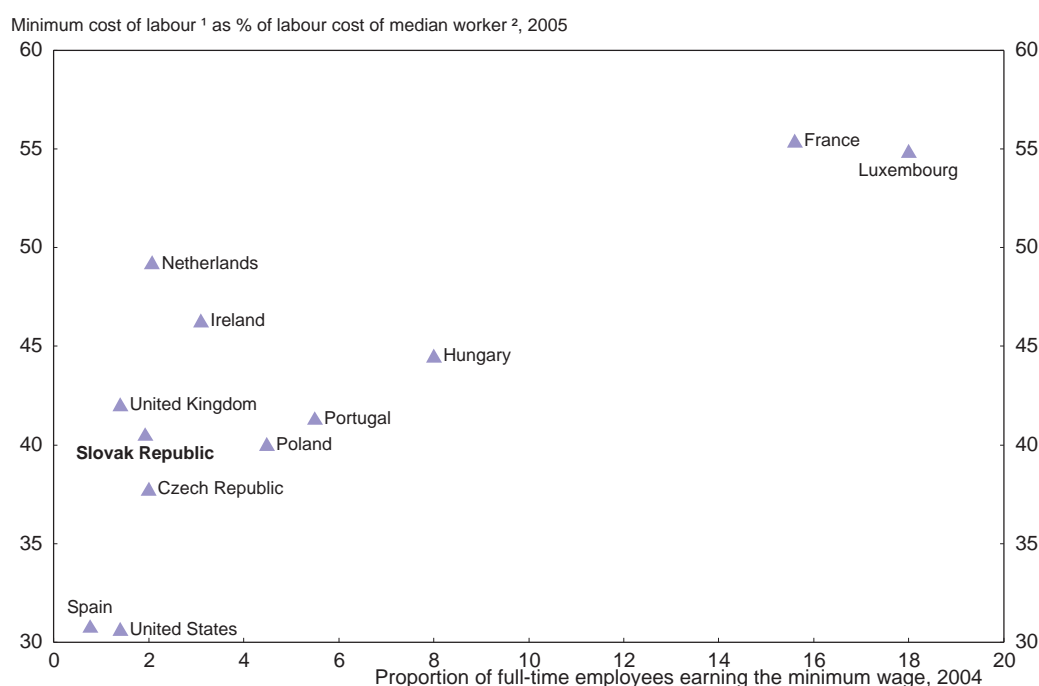
5. A temporary wage subsidy – which has a lower fiscal cost – would be more appropriate, relative to a permanent in-work benefit, in countries where income distribution is not a concern. The in-work benefit would combine improved work incentives with some income redistribution in favour of low-income households.

6. Year-on-year growth of average gross wage earnings amounted to 8% in the third quarter of 2006.

7. However, the proportion of workers earning the minimum wage may not be a sufficiently reliable guide to potential employment effects of the minimum wage. If the tail of the earnings distribution below the minimum wage level were long in the absence of the minimum wage, a low proportion of workers earning the minimum wage might be observed even if employment effects are substantial. Conversely, in a purely monopsonistic labour market in which a minimum wage (if set low enough) would have no adverse employment effects, workers whose market-determined wage would be below the minimum wage would all earn a wage equal to the minimum wage, resulting in a large share of workers earning the minimum wage, even though the minimum wage would not have negative employment effects (but possibly positive employment effects).

8. The Manifesto of the Government of the Slovak Republic, 2006.

Figure 2. Minimum compensation and proportion of full-time workers earning the minimum wage



1. The cost of labour is the sum of the wage level and the corresponding social security contribution paid by employers.
2. Exactly half of all workers have wages either below or above the median wage.

Source: Eurostat and OECD (2007), *Going for Growth*.

13. Experience from other OECD countries suggests that employment prospects of youth are particularly likely to be adversely effected by excessively high minimum wages. For this reason, the UK, where the ratio of minimum compensation relative to median compensation at the standard rate is similar to the ratio observed in the Slovak Republic, applies a minimum wage to workers below the age of 22 that is 15% lower than the standard minimum wage. In the Slovak Republic, lower minimum wage rates apply to youth below the age of 18 and 16. Most of these youth are, however, in full time education. The impact of minimum wages on employment should be assessed. Such an assessment should be used to determine whether a higher age threshold is required for the lower minimum wage rate applying to young workers. In addition to the absolute minimum wage, a range of four additional minimum wages is set in the Slovak Republic, with each minimum wage linked to specific job characteristics (such as amenities and skill requirements). This practice entails the risk that flexibility in relative wages across skills and across regions is hampered. It should be abandoned.

14. Decisions on minimum wages are taken in a two-stage process, involving both the social partners and the government. If the social partners agree on a minimum wage increase in the first stage, the agreed minimum wage increase is legislated. The government takes a decision on a minimum wage increase only if the social partners do not reach an agreement. While social partners have typically failed to reach an agreement in recent years, allowing the government to take the decision, this decision-making structure entails the risk that minimum wages would be set too high, as part of potential costs of minimum wage increases – namely unemployment-related benefit payments – would be born by the government which might not be party to the agreement. Significant increases in the minimum wage relative to the average wage should be avoided. Decisions on the minimum wage level should exclusively be taken by the government, based on evaluated employment effects of the minimum wage and its effectiveness in

reducing poverty. The government intends to minimize the risk that minimum wages would be set too high by setting up a list of criteria which would need to be taken into account by all parties involved in the setting of the minimum wage.

***Reforming health care funding could help lower the tax burden on labour***

15. Broadening the assessment base for health care contributions to all household income would lower the tax burden on labour to some extent, improving the employability of low-skill workers. Since health care insurance benefits – in contrast to pension and unemployment insurance benefits – bear no relation to labour earnings, both efficiency and equity considerations suggest funding of healthcare benefits ought not to be based on payroll contributions but on a broader measure of income.

**Further measures can be taken to reduce long-term unemployment**

***Active labour market policies need to be improved further***

16. The government has taken substantial steps in recent years to make active labour market policies (ALMPs) more effective. Counselling of job seekers is in the process of being made more closely adapted to their individual circumstances, for example, with the introduction of individual action plans and by increasing resources. The government is committed to continuing this reform process. Indeed, some weaknesses still need to be addressed; for example, a recent evaluation of counselling services has shown that the public employment service offices' equipment and staff resources are more limited in eastern regions, where unemployment is particularly high.<sup>9</sup>

17. The government also took a number of measures to strengthen the effectiveness of ALMPs. For example, acceptance of offers to participate in ALMPs was made compulsory for most measures and incentives for participants in training measures to make effective use of training have been raised by making the degree of reimbursement of training fees to participants to some extent dependent on subsequent take-up of a job. However, while evaluation of ALMPs is conducted, observers have noted that the design of ALMPs is not sufficiently linked to evaluation of their effect in terms of helping the unemployed to obtain unsubsidized jobs.<sup>10</sup>

18. Spending on active labour market policies (ALMPs) overall is relatively low (Table 1). Moreover, the number of participants in training measures, relative to the labour force, is very small, notwithstanding high unemployment, while the number of participants in direct job creation schemes, relative to the size of the labour force, is one of the largest in the OECD. Participants in direct job creation schemes do volunteer jobs for municipalities or non-profit organizations and receive a supplement to social assistance worth about 25% of full-time minimum wage earnings while the non-profit organizations and municipalities offering jobs in the scheme receive subsidies to cover any non-wage spending (such as capital outlays) related to the creation of these jobs. The target group of the scheme are the 'disadvantaged job applicants', comprising the registered unemployed who have been unemployed for more than 6 months, as well as unemployed graduates under the age of 25 and unemployed workers above the age of 50, regardless of the duration of their unemployment spell, although the primary target group is low-skill workers receiving social assistance who have registered as unemployed for more than 6 months. Placement in the scheme can be made compulsory on a case-by-case basis, although registered unemployed in the target group can also voluntarily apply for a place in the scheme.

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9. Hanzelová and Kostolná (2006).

10. Zachar (Ed.) (2006).

19. Effective ALMPs play an important role in raising the employability of the long-term unemployed.<sup>11</sup> Effective ALMPs are not only useful because of their direct impact in raising the effectiveness of job search of the unemployed but also because a higher degree of search effectiveness helps to damp wages when unemployment is high. Indeed, empirical evidence suggests that ALMPs reduce the extent to which aggregate unemployment responds to adverse economic shocks.<sup>12</sup> Cross-country evidence shows that the impact of ALMPs on subsequent labour market performance of participants varies strongly depending on programme design, indicating that evaluation of all schemes is important. Training measures for the unemployed, in particular, are associated with lower unemployment. Recent evaluation studies show that training measures compare favourably to other types of ALMPs especially if their long-term effects on employment prospects and wages of participants are taken into account.<sup>13</sup>

20. Short training programmes have proven effective in reducing unemployment durations, for example, in Germany, even in the short term. Recent micro-econometric evidence suggests that the evaluated measures have raised exit rates into employment by up to 70% over a period of 6 months following participation in such a programme.<sup>14</sup> The training measures comprise aptitude tests, courses teaching presentation techniques for job applicants, as well as, in some cases, specific vocational skills, with durations lasting between several weeks and at most 3 months. This scheme proved particularly effective in raising transitions to employment for unskilled workers, for whom these measures were focussed on aptitude testing with subsequent vocational training.<sup>15</sup>

21. Public job creation schemes for the unemployed, by contrast, have often proven ineffective in reducing unemployment durably, as the schemes are likely to displace workers on unsubsidized jobs and subsidies entail deadweight costs. Participants may be further detached from the unsubsidized labour market if job search diminishes as a result of participation. Indeed, in the Slovak Republic, social assistance recipients who participate in the public job creation scheme have to report less frequently for interviews at the Public Employment Service<sup>16</sup> than other registered social assistance recipients and interviews for participants in these schemes are considerably shorter, which is likely to reinforce the detachment of participants from the labour market.<sup>17</sup>

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11. See *e.g.* Martin (2001) for a description of which active labour market policies are effective.

12. OECD (2005c).

13. See OECD (2005c), which shows that higher spending on training measures relative to GDP is associated with lower unemployment rates across OECD countries. See also J. Boone and J. Van Ours (2004).

14. See Hujer, Thomsen and Zeiss (2006).

15. Kurtz (2003).

16. Participants in the public job creation programme are required to report to the Offices for Labour every month, whereas non-participants are required to report to the Labour Offices every week. Duration of follow-up interviews at the Public Employment Service – the Offices of Labour, Social Affairs and Family – are between 5 and 15 minutes long, rather than 20-60 minutes for the registered long-term unemployed who do not participate.

17. Hanzelová and Kostolná (2006).

Table 1. **Active labour market measures in cross-country comparison, 2004**

Programme categories and sub-categories	Austria		Belgium		Czech Republic	
	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force
1. PES and administration	0.17	..	0.23	..	0.12	..
2. Training	0.28	1.67	0.20	2.71	0.02	0.15
3. Wage subsidies	0.06	1.09	0.15	1.27	0.05	0.47
4. Direct job creation	0.04	0.12	0.46	2.54	0.03	0.19
5. Start-up incentives	..	0.02	–	0.02	0.01	0.12
Programme categories and sub-categories	Hungary		Netherlands		Slovak Republic	
	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force	Public expenditure as a percentage of GDP	Participant stocks as a percentage of the labour force
	2004	2004	2004	2004	2004	2004
1. PES and administration	0.11	0.10	0.32	..	0.081	..
2. Training	0.08	0.05	0.36	8.74	0.01	0.18
3. Wage subsidies	..	0.09	0.03	0.58	0.01	0.22
4. Direct job creation	0.06	0.05	0.18	0.05	0.04	3.78
5. Start-up incentives	0.01	0.01	..	..	0.02	0.11

1. Includes only spending on placement and related services, data on benefit administration not available.

Source: OCDE data base on active population statistics.

22. Public job creation schemes can, however, still be effective if used in a highly targeted fashion. Targeting employment creation schemes exclusively to the long-term unemployed minimises the risk that participants' entry into the unsubsidised labour market is delayed as a result of participation, as the long-term unemployed typically have lower exit rates into employment than the short-term unemployed. In countries where individual profiling is not yet developed, making participation in job creation schemes compulsory for all workers above a duration threshold may be a useful strategy. In Denmark such a duration threshold for compulsory participation in job creation schemes was introduced as part of efforts to improve activation in the course of the 1990s. The threshold was gradually reduced, as long-term unemployment declined.<sup>18</sup>

18. OECD (2005e), *Employment Outlook*.

23. Training measures for the unemployed should be expanded, especially for youth, while subsidized job creation should be more narrowly targeted. It should be ensured that introduction of new ALMPs is consistently linked to evaluation of the impact of the measures on transition from unemployment to unsubsidized jobs.

***Registration requirements need to be widened***

24. Registration of social assistance recipients who are capable of doing paid work as unemployed in the Offices is not compulsory. While benefit replacement rates for the unemployed are low, so most benefit recipients are likely to have some incentives to search for a job, compulsory registration could help to ensure that all social assistance recipients are included in activation measures. The social assistance supplement paid for an adult dependent is relatively large in relation to the standard allowance. The supplement lowers – as in most OECD countries – incentives for either partner to take up work, as both the standard allowance and the supplement are lost as one person moves into a job. Cohabiting partners of social assistance benefit recipients should therefore also in general be required to register as unemployed. Continuing to reform the Public Employment Service to raise its effectiveness and reforming ALMPs is important to make sure that wider registration leads to an increase in placements into jobs.

**Large regional differences in employment rates require regional wage differentiation and policies to encourage worker mobility**

***Housing policies could be more supportive of worker mobility***

25. As noted in the 2005 *Economic Survey of the Slovak Republic*, migration across the regions of the Slovak Republic is very low, contributing to a wide dispersion of employment rates across regions. Lack of mobility may severely constrain potential growth in future, as strong labour demand in prosperous regions is not met by excess labour supply in relatively poor regions. Moreover, insufficient mobility among youth slows the transition into a first job<sup>19</sup> and may restrain educational achievement, as lack of mobility reduces access to job opportunities and hence scope to amortise education investments.

26. The lack of development of the private rental market plays an important role in restraining mobility. Indeed the private rental market is very small, despite some recent growth. Letting apartments appears to be unattractive for private landlords because landlords find it difficult to enforce eviction, for example for non-payment of rents, as legal procedures appear to be excessively long. Moreover, the 2005 *Economic Survey of the Slovak Republic* noted that regulations remain onerous for landlords, and no legislative initiatives have been taken to improve the development of the private rental market since.

27. Government policies have encouraged owner-occupancy, through subsidies for private household housing loans (see the 2005 *Economic Survey of the Slovak Republic*). Moreover, the government intends to introduce an additional mortgage subsidy for families purchasing housing for own occupation. High rates of owner-occupancy across OECD countries appear to be associated with higher unemployment.<sup>20</sup> Moreover, if euro area entry is achieved, real interest rates are likely to be very low, which suggests that housing loan subsidies would further fuel a credit boom and a steep rise in housing prices, which would adversely impact mobility. With housing prices already rising steeply in some regions, availability of land for residential construction is important.

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19. Many youth live in fact with their parents, as shown in OECD (2007b).

20. OECD (2005c).



28. The government is committed to stepping up construction of public sector-provided rental housing, which has long waiting lists, discouraging mobility. Central government subsidies for public housing construction are made available to the municipalities which are in charge of realising construction projects. With all municipalities eligible to central government housing construction subsidies, there is a risk that the subsidies may not be sufficiently targeted at those regions where housing demand is growing the strongest. Indeed, steep housing price increases in Bratislava suggest that housing demand growth is not regionally balanced.

29. Priority should be given to removing hurdles to private rental market development, reviewing regulation and improving law enforcement. Mortgage interest subsidies should be abolished while the availability of land for residential construction should be ensured. Public sector housing construction should be targeted to regions where housing demand is the strongest, with rents for middle and high income households set in line with market rental rates. Ensuring that middle and high-income households occupying public sector housing pay market rental rates could help reduce waiting lists in public sector rental accommodation and contribute to better targeting of subsidies. In the longer term, when the private rental market develops, public sector housing construction should be replaced by a cash housing benefit, as recommended in the 2005 Economic Survey of the Slovak Republic.

30. Moreover, in view of substantial upfront relocation costs, mobility is constrained by liquidity constraints faced by low-income workers – especially in middle-income countries such as the Slovak Republic –, as these workers cannot borrow against future income arising from a new job taken up in a more prosperous region.<sup>21</sup> A small subsidy – 1 000 SKK (7.5% of the average monthly wage in 2005) – was available to the long-term unemployed to meet moving costs when taking up a job in a different location. It was however abolished in 2005 owing to low take-up.<sup>22</sup> Liquidity constraints among the unemployed might be more effectively addressed through a government-sponsored loan scheme, for example, for the long-term unemployed, which would minimize budgetary costs while allowing the amount of support to be larger. Consideration could be given to introducing a government loan scheme to assist with mobility costs for the long-term unemployed, subject to evaluation.

### ***Regional flexibility of wages needs to be safeguarded***

31. Wage flexibility across regions is important to ensure higher employment in relatively weakly developed regions, especially in view of low regional mobility. Nation-wide sectoral wage settlements – as practiced in the Slovak Republic – entail risks for regional wage differentiation, especially if settlements are legally extended to firms not covered by the agreements. Moreover, empirical evidence suggests that moving from nation-wide industry-level bargaining to firm-level bargaining increases the degree to which wage setting responds to macroeconomic shocks with benefits for resilience, especially after the planned entry in the euro area.<sup>23</sup> A step towards ensuring such decentralisation of wage setting was the abolition of legal extension of sectoral wage settlements in 2004. Legislation was however passed in February 2007 to reintroduce the legal extension of collective wage bargaining outcomes to firms which do not participate in collective wage bargaining, although with the possibility for individual employers to request exoneration from legal extension by the government on grounds of differences in socio-economic conditions, such as firm characteristics or local labour market conditions. Legal extension of collective bargaining could adversely impact employment in regions where employment rates are already relatively low. *The*

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21. See Huber (2006).

22. INEKO (2005).

23. For evidence on the UK, see Faggio and Nickell (2005). See also OECD (2005c).

*authorities should make liberal use of their powers to accept requests for exoneration from legal extension so as to limit the loss of responsiveness of wages to local conditions,*

***Infrastructure development should be given priority over subsidies for large investment projects***

32. The government introduced a new system of subsidies for large greenfield investment projects in 2005, which aims at both supporting job creation in relatively poor regions as well as at attracting investment in industries considered to have high technological potential. The scheme, foresees paying subsidies at a fixed rate relative to the cost of the investment, with the rate depending on the level of unemployment in the district in which the investment project is to be made as well as on the sector of the industry. High unemployment districts are eligible for higher subsidy rates. For any given district, industries considered to have a high technological potential – such as biotechnologies and ICT – attract higher subsidy rates.

33. While little empirical evidence on the impact of investment subsidies for regions with poor employment performance is available, evidence for such subsidies in the UK point to limited effectiveness of such schemes in raising employment performance in targeted regions. A factor that could limit effectiveness in the Slovak Republic is that the subsidies encourage capital-intensive production rather than labour-intensive production, adding to incentives in favour of capital-intensive production inherent in the tax system, which taxes the returns of capital relatively modestly and the returns of labour, notably unskilled labour, relatively highly. Empirical evidence suggests that fiscal incentives – as measured by effective corporate tax rates – do not play a large role in determining foreign direct investment flows, although how such incentives compared with incentives set by neighbouring countries seems to play a larger role.<sup>24</sup> Moreover, in the case of subsidies, further deadweight loss arises because the subsidies cannot target net direct capital inflows into targeted regions, as the subsidies are not generally repayable when subsidised production plants are closed down. Moreover the project size threshold favours large enterprises, which distorts competition across firms of different size. In addition, large firms are generally found to be more likely to pay wage *premia* over and above market-clearing wages, reflecting the presence of firm-specific rents related to firm size, which may further limit the scheme's effectiveness in fostering employment, and the subsidies may further raise such *premia*.

34. Thus, while foreign direct investment has clear macroeconomic benefits, notably in terms of productivity growth, the case for providing subsidies for large-scale investment projects is less clear. Indeed the *OECD Jobs Study* has reached the conclusion that public investment in infrastructure is a preferable means to strengthen labour demand in less developed regions. The government plans to increase government infrastructure investment, notably in projects to improve road and railway transport links of the less developed central and eastern regions with western regions, supported by contributions from the European Union. Infrastructure development should be given priority over subsidies for large investment projects in supporting the economic development of the low employment regions. The government is planning to revise the subsidy scheme. The subsidy scheme could be given a fixed time span sufficient to allow evaluation of the employment and productivity spill-over effects. A subsequent decision to renew the subsidy scheme should be made dependent on evidence on the effectiveness of the scheme.

**Caution is required in reforming employment protection legislation**

35. In current employment protection legislation (EPL), compensation and reinstatement provisions applying to unfairly dismissed workers are relatively generous in comparison with other OECD countries,

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24. See Hajkova *et al.* (2006), who investigate fiscal incentives provided by corporate tax systems.

while the definition of unfair dismissal is relatively narrow.<sup>25</sup> This may well be an appropriate policy setting to deter discriminatory behaviour by employers. At present, employment protection for permanent contracts, while not among the most liberal in the OECD, does not appear overly restrictive. Indeed, the moderate stance of EPL has helped to keep the proportion of workers on temporary contracts relatively low, at about 5%, even though the regulatory stance on temporary contracts is relatively liberal: restrictions on the use of such contracts are modest; there are no limits to “chains” of temporary contracts; and a temporary contract can last up to three years.

36. The government is considering legislation to tighten EPL. In particular, the government is planning to widen severance pay entitlements to all workers who have been made redundant. At present redundancy entitlements only arise if workers decide to leave the dismissing firm before the expiry of the notice period, in which case workers receive a severance payment equal to the pay in the remaining notice period, up to a maximum of two months pay. In addition, the government is considering, *inter alia*, restricting regulation of temporary contracts. In particular, the government is planning to reduce the reasons which allow the use of temporary contracts as well as to limit “chains” of subsequent fixed-term contracts and to shorten the maximum duration of such contracts. According to the plans temporary workers would have the right to the same level of pay as workers accomplishing comparable tasks on permanent contracts. Planned changes also include the introduction of social criteria in redundancy rules. In particular, mothers of young children who are less than 3 years old would be protected from redundancy.

37. While the empirical evidence does not establish a negative impact of tight EPL on overall employment in general, tightening EPL can have some undesirable effects. Empirical evidence suggests that stricter EPL can reduce the responsiveness of nominal wages and prices setting to labour market conditions, which might reduce the resilience of the economy to shocks.<sup>26</sup> Moreover, the impact of tighter EPL on overall employment can only be neutral if costs associated with tighter EPL are passed on to workers, which entails a lower wage level. Stricter EPL reduces employment prospects of women and youth, relative to men and older workers,<sup>27</sup> and lengthens the duration of unemployment spells. Tightening EPL for workers on permanent contracts also tends to lead to labour market segmentation, entailing an increase in the number of workers on temporary contracts and with precarious work conditions. Stricter EPL can interact with significant increases in the minimum wage, as a binding minimum wage would limit the extent to which such costs could be passed on to wages, which would result in a negative impact of tighter EPL on overall employment. While there is no clear evidence that stricter EPL reduces productivity,<sup>28</sup> strict EPL reduces the reallocation of workers, including through lower voluntary job mobility, especially if the degree of protection increases with job tenure, which may be of particular importance in a country such as the Slovak Republic that is undergoing fast technological change.

38. A case can be made in favour of severing the link between redundancy pay and the timing of the worker’s departure to another job, as envisaged in the government manifesto. Assuming workers can be gainfully employed during the advance notice period, the current rules imply higher costs for dismissing

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25. See OECD (2004).

26. The evidence in Cournède *et al* (2005) suggests that higher EPL flattens the short-term Phillips curve when unemployment exceeds the nonaccelerating inflation unemployment rate. OECD (2005c) and references therein show that stricter EPL *lowers* the magnitude of an increase in unemployment following a shock but lengthens the time span needed to reverse the increase in unemployment.

27. See OECD (2005c).

28. See OECD (2003) for empirical evidence.

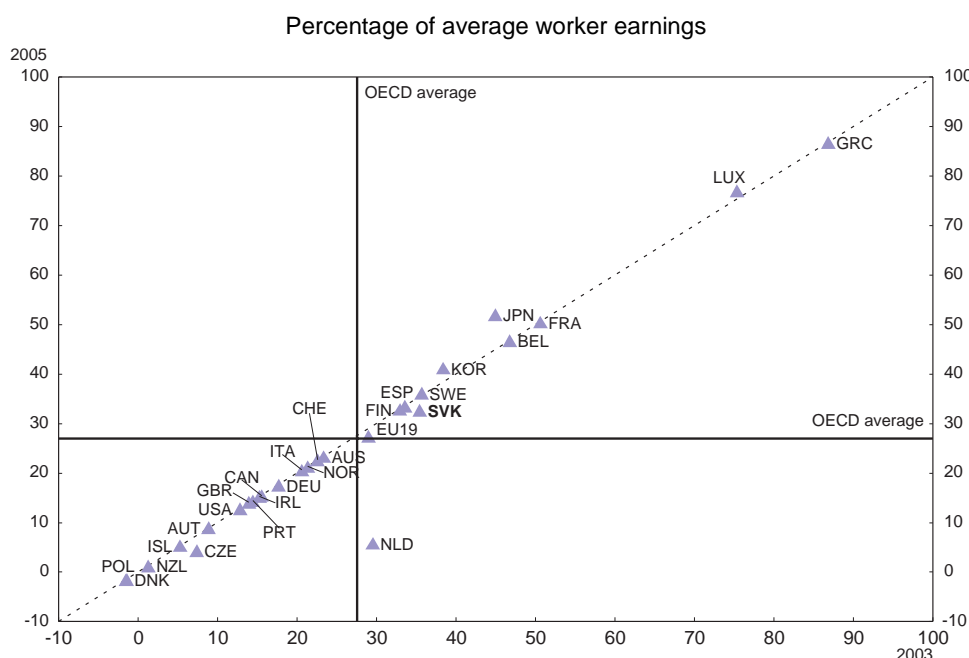
workers who can find another job quickly, which would tend to bias firms' redundancy decisions towards making those workers redundant who are the least likely to find another job, which may in turn raise unemployment. However, while it appears to be envisaged that redundancy payments remain limited to two months of pay, it would need to be ensured that redundancy payment is low for short tenures, given that regulation of temporary contracts may be tightened. Introducing protection for special groups would need to be weighed against potential barriers in hiring, for example, of young women. The government should avoid imposing significant increases in employment costs through reform of employment protection legislation.

### Disincentives to supply labour among older workers need to be lowered

39. Low participation rates of older workers result in part from the relatively low statutory retirement age. The standard retirement age reached 62 years for men in 2006 and is being raised to 62 for women by 2014, which is still lower than in most OECD countries. While life expectancy is at present shorter than in high-income OECD countries, which brings the duration of retirement relative to economically active life broadly into line with other OECD countries, life expectancy is likely to increase relatively quickly as living standards rise. Adjusting the age of retirement in line with gains in life expectancy is therefore essential.

40. Incentives to retire early also result from relatively small pension discounts which apply to the first-pillar pay-as-you-go earnings-related pension for retirement before the standard retirement age. Pension discounts for earlier retirement and supplements to pensions for later retirement were raised to 6% per year in 2004 but remain below the level implied by actuarial neutrality (around 8%). The implicit tax on continued work – the loss in the present value of expected pension payments received, net of the present value of pension insurance contributions made, as a result of working for one additional year – is higher than in many other OECD countries (Figure 3).

Figure 3. Implicit tax rate on continued work<sup>1</sup>



1. Implicit tax on continued work in regular old-age pension systems, for 60 years old.

Source: Duval, R. (2003), "The retirement effects of old-age pension and early retirement schemes in OECD countries" and OECD calculations.

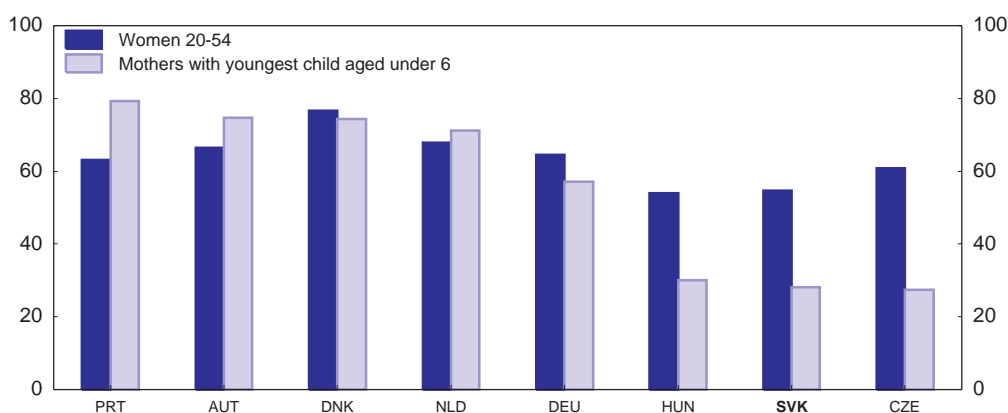
41. This avenue into early retirement is curtailed to some extent – notably for workers on relatively modest earnings – by the requirement that workers may only retire before the statutory retirement age if they have accumulated sufficient contributions to qualify for a pension above a minimum level equivalent to roughly the minimum wage. However, this provision, together with the relatively low pension discounts, implies redistribution of income from workers with small pension entitlements to workers with large pension entitlements, as workers with large pension entitlements can raise the present value of their pension entitlement by retiring early while having the increase in their pension wealth financed by the contributions of other workers. Raising the discounts applying to old-age pensions in early retirement to actuarially neutral rates would thus be desirable both on efficiency and equity grounds.

### Policies need to become more supportive of female labour supply

42. Relatively low average household income levels and a tradition of strong female labour supply are still sustaining a relatively high participation rate among prime-age women. However, childcare policies are likely to be one factor contributing to the decline in participation of young women over the past decade. The difference in the employment rate of women with children less than 6 years old and women with no children is similar to that in other central European countries that adopted similar policies but is considerably larger than in other OECD countries (Figure 4). Prolonged non-employment among young women raises the risk that some young women may not return to work and that, for those who do, career progression is slowed. The resulting reduction in labour input would reinforce the decline in potential employment resulting from demographic development, lowering living standards.

Figure 4. **Employment rates of women with young children**

As percentage of female working age population, 2002



Source: OECD (2005b) and OECD Labour Force Statistics database.

43. Non-employment among women with children is also likely to increase poverty risk. To lower the incidence of poverty among families with children, the government has recently increased child cash benefits. While child benefits can help to lower child poverty and child benefits are relatively low in the Slovak Republic,<sup>29</sup> the loss of labour income that results from non-participation of women in the labour market would be difficult to offset even with a generous child benefits system and would need to be

29. The difference in the tax payments – net of all child benefits – between households without children and households with children is among the lowest in the OECD according to d'Addio and Mira d'Ercole (2005), although childcare benefits have undergone changes since.

financed through taxation which in turn weighs on labour supply. Moreover, payment of child benefits itself lowers female labour supply, suggesting that measures encouraging stronger labour market attachment for young women would both help to raise average living standards and reduce child poverty.

### ***Reform of parental benefits would boost labour supply of young women***

44. Parental leave benefits, which currently amount to about 20% of the average monthly wage, are paid for a period of up to three years and are tied to a statutory right to return to the job held previously. The benefit is generally conditional on one parent working and one parent staying at home to look after the child, although a parent can also receive the benefit if both parents work, if the full amount of the benefit is used to pay for childcare.<sup>30</sup> However, if the child is sent to a government-subsidized childcare facility, the benefit entitlement is relinquished and few parents appear to have found the option of combining benefit receipt with work worthwhile taking up. Substantial scope remains to raise coverage of children by formal early education and childcare facilities (see Carey, 2007).

45. Empirical evidence suggests that payment of parental leave benefits linked to a guaranteed re-entry into the job occupied before parental leave can have a positive impact on women's decisions to work, as parental leave makes it easier for women to reconcile work and the raising of children, provided the duration of the entitlement is not excessively long. The reemployment guarantee raises the cost to employers of employing leave beneficiaries, which can be expected to result in lower wages, and if the cost is sufficiently large, lower employment. Prolonged absence from the labour market may also lead to skill attrition. Indeed, empirical evidence suggests that a negative effect of parental leave entitlements on women's wages sets in if the duration of parental leave exceeds 8 months while a negative effect on female employment is estimated to arise if parental leave entitlements exceed 20 months.<sup>31</sup> At the same time, raising the coverage of children with childcare facilities has a significant positive impact on female labour supply, both on account of a reduction in financial childcare costs as well as a reduction in commuting time owing to a denser network of childcare facilities.<sup>32</sup> In view of these considerations, the duration of the parental leave benefit entitlement should be shortened considerably, with the benefit for the remaining period up to three years being paid in the form of subsidies for childcare. Carey (2007) presents detailed recommendations on policies towards childcare and early childhood education.

### ***Hurdles to part-time employment need to be removed***

46. Exemptions of part-time employment from various EPL provisions may make part-time work less attractive, potentially reducing labour supply among workers who would only consider working part-time, such as women raising children. While dismissing full-time workers requires an advance notice of at least two months, the advance notice period is 15 days for employees working less than twenty hours. In addition, provisions related to unfair dismissals and to collective dismissals do not apply to part-time workers. These exemptions are likely to foster labour-market segmentation, making part-time work more precarious, and may reduce the amount of training part-time workers receive on-the-job. While easing employment protection in general raises employment rates of women, as shown in OECD (2005c), exempting part-time workers is unlikely to have the same favourable impact.<sup>33</sup> Moreover, the EPL regime

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30. This provision is recent and is therefore not reflected in the statistics presented in Figure 2.4.

31. See Jaumotte (2003) and the references cited therein.

32. See Jaumotte (2003) for estimates of the impact.

33. By increasing worker turnover, and thereby the hiring rate, a liberal EPL regime for all workers favours female employment because women are more likely than men to desire multiple entries into the labour market over their working life. This effect is much reduced if liberalisation is restricted to part-time work.

for regular workers is, at present, not overly restrictive in the Slovak Republic. Eliminating exemptions from EPL for part-time workers is therefore unlikely to lower labour demand for such workers under current EPL rules. Indeed the government is considering lowering the threshold below which exemptions apply to 15 hours per week and plans to increase the notice period applying to part time workers to 30 days. The arguments above suggest, however, that exemptions of part-time workers from employment protection legislation provisions could be abolished entirely, making EPL the same regardless of working time, provided the general EPL regime is not made significantly more restrictive in the current revision of labour law.

***The tax system discourages labour supply of second earners***

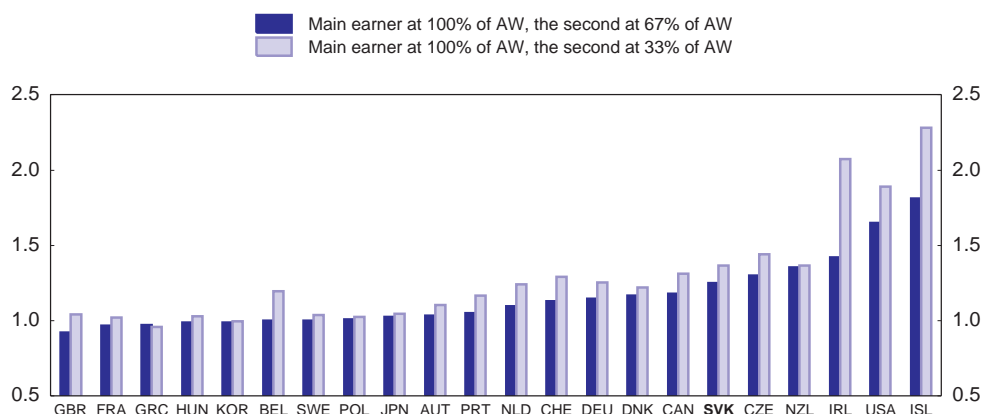
47. A relatively high tax burden on labour supplied by second earners in households, relative to the tax burden on the main earner, also tends to discourage female labour supply. Since women's labour supply decisions are typically more sensitive to variations in the net wage than men's, reducing the extent to which second earners are taxed relative to main earners raises overall labour supply; the downside is that such a step typically compromises horizontal equity, in the sense that disposable income of one-earner households with a non-working spouse is pushed below the disposable income of a two-earner household with the same gross earnings.

48. In the Slovak Republic, the tax wedge on the earnings of a secondary earner in a household, relative to the tax wedge on the main earner, is higher than in many OECD countries (Figure 5). The relatively high tax wedge on the second earner mainly results from the structure of personal income taxation. In particular, single earners with a non-working spouse benefit from a doubled basic income tax allowance, with earnings from the spouse taxed from the first koruna onwards once the spouse decides to take up work.<sup>34</sup> A further option to rebalance the tax wedge on the main and the secondary earner would be to introduce a health insurance surcharge for households with couples in which only one person works. At present non-working spouses are insured for free. The tax wedge on second earners in two-earner households should be reduced by lowering the tax allowance for non-working spouses. Consideration should be given to introducing a surcharge on health insurance for non-working spouses, with resulting revenues used to lower the health care insurance payroll contribution rate. Such a surcharge is in place in Austria.

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34. Formally, the main earner's allowance for the non-working spouse is withdrawn in line with increasing labour earnings of the spouse until the spouse's earnings exceed the basic income tax allowance. Both earners, however, remain subject to separate assessment for tax purposes.

Figure 5. **Relative tax wedge on second earners, 2005**  
 One-earner married couple with 2 children at 100% of average earning = 1



Source: OECD (2006), Taxing Wages database.

## Box 2. Policy recommendations to improve labour market performance

### Lower barriers to the employment of low-skill workers with an in-work benefit

*The introduction of in-work benefit should be considered, with the level of the benefit depending on the number of children in the household. The benefit should be subject to a minimum requirement on hours worked and be phased out gradually above a household income level determined by a poverty threshold. The in-work benefit could replace the tax bonus and temporary wage subsidies for social assistance recipients moving to a job.*

*The assessment base for mandatory health insurance should be widened to a comprehensive measure of household income.*

### Reduce the risk of poverty traps in the reformed pension system

*Redistribution should be introduced among mandatory pensions. To this end mandatory pensions could be subject to personal income tax (either EET or TEE) and resulting revenues be used to raise 1<sup>st</sup> pillar pensions, leaving the average net pension unchanged.*

*The rate at which social assistance payments to pensioners are withdrawn as pension income rises should be lowered with budget costs financed by cutting the tax advantages for voluntary third-pillar pension saving schemes. The old-age social assistance supplements could be reviewed.*

*The requirement that 30% of financial investments in the second-pillar pension scheme be directed to domestic assets should be phased out so as to returns and hence, reduce the proportion of pensioners with entitlements that fall below social assistance.*

### Ensure minimum wages are set such that they do not harm employment prospects of low-skill workers

*Significant increases in the minimum wage relative to the average wage should be avoided. Decisions on the minimum wage level should exclusively be taken by the government.*

*The impact of minimum wages on employment should be assessed to determine whether a higher age threshold is required for the lower minimum wage rate applying to young workers.*

*The practice of setting several minimum wages for jobs with different characteristics should be abandoned.*



### **Improve activation of the long-term unemployed**

*Training measures for the unemployed should be expanded, especially for youth, while subsidized job creation should be more narrowly targeted. Introduction of new ALMPs should be consistently linked to evaluation of the impact of the measures on transition from unemployment to unsubsidized jobs.*

*All social assistance recipients as well as jointly assessed adult dependents not in full-time education who are capable of taking up a job should be required to register as unemployed and be subject to job search and job acceptance requirements.*

*The capacity of PES to provide effective job-search assistance and monitoring needs to be strengthened.*

### **Remove impediments to mobility of workers within the Slovak Republic**

*Priority should be given to removing hurdles to the development of the private rental market, reviewing regulation and improving law enforcement.*

*Mortgage interest subsidies should be abolished while the availability of land for residential construction should be ensured.*

*Public sector housing construction should be targeted to regions where housing demand is the strongest. Middle and high-income households occupying public sector rental housing should pay unsubsidized market rental rates. In the longer term, when the private rental market develops, public sector housing construction should be replaced by a cash housing benefit, as recommended in the 2005 Economic Survey of the Slovak Republic.*

*Consideration could be given to introducing a government loan scheme to assist with mobility costs for the long-term unemployed, subject to evaluation.*

### **Focus government spending to support economic growth in high unemployment regions on infrastructure development**

*Infrastructure development should be given priority over subsidies for large private sector investment projects in supporting the economic development of the low employment regions.*

### **Ensure wages adjust to disequilibria in the labour market**

*The authorities should make liberal use of their powers to accept requests for exoneration from legal extension so as to limit the loss of responsiveness of wages to local conditions*

*No substantial additional employment costs should be imposed through reform of employment protection legislation.*

### **Remove barriers to higher participation of older workers and women**

*The statutory retirement age should be indexed to gains in life expectancy once the increase in retirement age for women to 62 has been phased in by 2014.*

*Pension discounts for retirement before the statutory retirement age as well as supplements for retirement after the statutory retirement age should be raised to levels implied by actuarial neutrality.*

*The duration of parental leave benefit entitlement should be shortened, with the benefit for the remaining period up to three years being paid in the form of subsidies for childcare.*

*The tax wedge on second earners in two-earner households should be reduced. To this end the tax allowance for non-working spouses should be reduced by lowering the marital income allowance. Consideration could be given to introducing a surcharge on health insurance for non-working spouses, with resulting revenues used to lower the health care insurance contribution rate.*

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